No. 45

In the Supreme Court of the United States

OCTOBER TERM, 1941

THE UNITED STATES, PETITIONER

v.

THE KANSAS FLOUR MILLS CORPORATION

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

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OPINION BELOW

The opinion of the court below (R. 9) is reported in 92 C. Cls. 390.

JURISDICTION

The judgment of the Court of Claims was entered January 6, 1941 (R. 10). The petition for a writ of certiorari was filed March 31, 1941 (R. 10), and was granted May 12, 1941 (R. 11). The jurisdiction of this Court rests on Section 3 (b) of the Act of February 13, 1925, as amended by the Act of May 22, 1939.

QUESTION PRESENTED

Respondent agreed to sell flour to the United States at stated prices. The contracts provided that such prices "include any Federal tax heretofore imposed by the Congress," and that if any taxes are thereafter "imposed or changed by the Congress * * * and are paid to the Government by the contractor" then the contract price "will be increased or decreased accordingly". Certain processing taxes were included in the contract price, but as a result of an injunction against collection, were never paid. The question is whether the contract price should be reduced by the amount of the unpaid taxes.

STATUTES AND REGULATIONS INVOLVED

The pertinent portions of the statutes and regulations involved are set forth in the Appendix.

STATEMENT

The special findings of fact of the Court of Claims (R. 5–9) may be summarized as follows:

Respondent in 1936 entered into four contracts with the United States covering the sale of wheat flour and wheat bran for a total consideration of $23,288.11. The flour and bran were delivered and vouchers in the amount of $23,288.11 were forwarded to the General Accounting Office (R. 5–7).

Payment of the vouchers was withheld by the Comptroller General, and notices were sent to the respondent during March and May 1937, on the

ground that respondent had been overpaid in an amount aggregating $28,419.20 on eight earlier contracts covering the sale of flour to the United States, entered into between May 1935 and January 6, 1936. This amount represented the Agricultural Adjustment Act processing taxes on the flour covered by the eight contracts, and was arrived at by applying the conversion factor of .704 cents per pound [1] to the total amount of flour delivered under each of the eight contracts (R. 6–8). As a result of an injunction obtained by respondent against the collection from it of any processing taxes, and the decision in *United States* v. *Butler,* 297 U. S. 1, no processing taxes were paid by respondent on the processing of wheat used in the manufacture of the flour covered by the eight contracts and no part of the $28,419.20 was ever paid to the United States (R. 6–8).

Each of the eight contracts contained the following provision (R. 7):

> Prices set forth herein include any Federal tax heretofore imposed by the Congress which is applicable to the material purchased under this contract. If any sales tax, processing tax, adjustment charge or other taxes or charges are imposed or changed by the Congress after the date set for the opening of the bid upon which this

[1] The finding of the Court of Claims is ".00704 cents per pound," but the error is obvious and typographical. See T. D. 4579, XIV–2 Cum. Bull. 483, 487.

> contract is based and made applicable directly upon the production, manufacture, or sale of the supplies covered by this contract, and are paid to the Government by the contractor on the articles or supplies herein contracted for, then the prices named in this contract will be increased or decreased accordingly, and any amount due the contractor as a result of such change will be charged to the Government and entered on vouchers (or invoices) as separate items.

On April 20, 1938, respondent filed this suit in the Court of Claims to recover on the four 1936 contracts, and contested the off-sets claimed by the Government arising out of the eight 1935 contracts (R. 1). The Court of Claims entered judgment in favor of respondent in the amount of $23,288.11, relying primarily upon its earlier decision in *Ismert-Hincke Milling Co.* v. *United States,* 90 C. Cls. 27.

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that the Comptroller General was not entitled to credit, against amounts due on later contracts, amounts paid respondent on earlier contracts in reimbursement for processing taxes which the contractor never paid.

2. In failing and refusing to hold that respondent was erroneously overpaid under the contracts involved in the amount of the processing taxes included in the contract price.

3. In failing and refusing to hold that the contracts provided for adjustment of the prices therein to compensate for the changes in the applicable federal taxes resulting from the injunction obtained against collection of the taxes and the decision in *United States* v. *Butler,* 297 U. S. 1.

4. In holding that the amounts included in the contract prices to compensate for processing taxes were buried in such prices and could not be segregated therefrom.

5. In failing to hold that price adjustments were necessary notwithstanding the absence of any express congressional repeal of the processing taxes imposed by the Agricultural Adjustment Act.

6. In failing to hold that, if congressional action were necessary, the comprehensive statutory machinery established by Congress in 1936 for refunds of processing taxes constituted such congressional action.

7. In failing to enter judgment for the United States and dismissing the petition.

SUMMARY OF ARGUMENT

A. (1) The tax clause in these contracts provided for price adjustments to reflect any change made in the processing tax "by the Congress." The court below ruled that the invalidation of the processing tax in *United States* v. *Butler,* 297 U. S. 1, was not a change contemplated by the contract. The decision ignores the Revenue Act

of 1936, 49 Stat. 1648. Title VII makes elaborate provision for the refund of processing taxes, Title III taxes the unjust enrichment which arose from passing on to customers the burden of unpaid taxes, and Title IV authorizes floor stocks refunds to those who held goods for sale on January 6, 1936. Each affords explicit recognition by Congress that the processing tax terminated on the date of the decision of this Court in the *Butler* case. The Revenue Act of 1936, accordingly, eliminates the processing tax liability from the statute books. This elimination of liability, even if its practical effect was merely cumulative, was a change made by Congress, within the meaning of the tax clause.

(2) The answer becomes doubly clear when one leaves the bare words of the tax clause of the contract and looks to "the relations of the parties, * * * and the circumstances under which it was signed." *Rock Island Railway* v. *Rio Grande Railroad,* 143 U. S. 596, 609. The Government had a dual relationship with the respondent. It was, on the one hand, the tax collector; on the other, it was the purchaser of taxable articles. The obvious purpose of the tax clause was to insure to the contractor a stable margin of profit and to give to the Government the certainty that increased or decreased tax collections would be precisely offset by corresponding price changes. See *United States* v.

Glenn L. Martin Co., 308 U. S. 62; *United States* v. *Cowden Mfg. Co.*, 312 U. S. 34. This purpose would be frustrated if a tax change so sweeping as complete invalidity were to be ignored.

It is true that the lower courts have consistently ruled that tax clauses in private contracts do not permit recovery by the private vendee. These decisions are inapplicable here. For the private vendee, as the courts have noted, resold the product and recouped the amount of the tax from his customers. Recovery of the amount of the tax from the vendor would, accordingly, simply result in unjust enrichment of the vendee and would be unrelated to the contingency against which the private vendee sought protection: sale of the product in a market in which the prices had been reduced by elimination of the tax liability. Here, the tax clause was designed to guard against a loss in the Government's revenues.

B. The same result is reached even if the tax clause were wholly ignored. The Government and the respondent agreed in the contract that the prices included federal taxes heretofore imposed by the Congress. Both parties assumed that the processing tax would be collectible. This mutual mistake is doubtless one of law and would probably defeat recovery if a private vendee sought to reform the contract. But it is settled that the United States can recover moneys paid out, even under contract, whether the mistake be one of law or of fact. *Wisconsin Central R'd.* v. *United States*, 164 U. S.

190; *Grand Trunk W. R. Co.* v. *United States*, 252 U. S. 112. This basic distinction, rooted in public policy, between the contracts of the United States and those of private persons makes inapplicable the decisions of the lower courts dealing with private vendees.

C. If there were any doubt as to the purpose of the tax clause, or of the right of the United States to recover mistaken payments such as these, it should be removed when it is considered that our arguments are conjoint. The tax clause should operate with added vigor to accomplish the purpose of the parties when through it the Government seeks recovery of mistaken payments, and certainly the United States should recover erroneous payments when in addition the parties have contracted to that same general end.

ARGUMENT

THE UNITED STATES IS ENTITLED TO THE AMOUNT OF THE UNPAID PROCESSING TAX

In a series of contracts respondent agreed to sell flour to the United States at stated prices. The United States possessed a dual relationship to respondent: first, it was the purchaser of a commodity subject to certain federal taxes, and second, it was the sovereign which had imposed and would collect those taxes. With this dual relationship in mind, the parties drew a tax clause designed to obviate the effect upon the contract price and upon the contractor's margin of profit of any subsequent

changes in federal taxes imposed directly on the contract articles. To reach that result they provided that the contract price included any federal tax imposed by Congress prior to the bid date, but that any subsequent changes by Congress in the applicable taxes were to be reflected by changes in the price. The purpose of this provision is clear. The contractor and the United States each were to be protected against subsequent tax changes which would increase costs or diminish revenues.

Respondent was here paid a contract price which included the processing taxes theretofore imposed and was consequently reimbursed for those taxes, even though an injunction had been obtained against their collection. The payments were premised on the assumption by the disbursing officers that the Agricultural Adjustment Act was a constitutional enactment and that the injunction would ultimately be dissolved. But, as a result of *United States* v. *Butler*, 297 U. S. 1, and *Rickert Rice Mills* v. *Fontenot*, 297 U. S. 110, the injunction remained in force and the taxes were therefore never paid. Thus, the respondent received reimbursement for taxes which it had not paid and which it had no legal obligation to pay.

It is against the background of these considerations that the contract must be construed. Our position is twofold. We contend, first, that the adjustment provisions in the contract require that the purchase price be reduced by the amount of

the unpaid taxes, and second, that even if there were no such adjustment provisions in the contract respondent was not entitled to reimbursement for taxes which it did not pay. Under either theory the Comptroller General properly deducted the amount of these reimbursed but unpaid taxes from the amounts due respondent.[2]

A. UNDER THE TERMS OF THE CONTRACT THE PRICE SHOULD BE REDUCED IN THE AMOUNT OF THE PROCESSING TAXES

1. *The Change in Tax Liability Comes Within the Language of the Tax Clause.*—Each of the contracts contained the following tax clause (R. 7):

> If any sales tax, processing tax, adjustment charge or other taxes or charges are imposed or changed by the Congress after the date set for the opening of the bid upon which this contract is based and made applicable directly upon the production, manufacture, or sale of the supplies covered by this contract, and are paid to the Government by the contractor on the articles or supplies herein contracted for, then the prices named in this contract will be increased or decreased accordingly * * *.

The Court of Claims decided this case upon the authority of its decision in *Ismert-Hincke Milling Co.* v. *United States*, 90 C. Cls. 27. There it held that the contract price should not be reduced by

[2] It is not questioned that, if respondent was overpaid on the earlier contracts, the deductions were proper. See section 305 of the Budget and Accounting Act, *infra*; *United States* v. *Burchard*, 125 U. S. 176, 180.

the amount of the unpaid taxes because "the grounds for any change in the price were stated [in the tax clause] clearly and without ambiguity, leaving nothing to be inferred or implied" (90 C. Cls. at 35). One judge, with whom another concurred in result, reached the same conclusion in *United States* v. *Hagan & Cushing Co.*, 115 F. (2d) 849 (C. C. A. 9). In *United States* v. *American Packing & Provision Co.* (C. C. A. 10), decided Aug. 20, 1941, Prentice-Hall Tax Service, par. 62,898, the court held for the Government on the grounds of equity and good conscience (*infra*, pp. 24–27) but agreed as to the construction of the tax clause. We think that this construction confines the tax clause to words alone, barren of the intent of the parties. Nevertheless even under a literal reading of those words, the tax clause permits adjustment for unpaid processing taxes.

The difficulty here is not, as in *United States* v. *Glenn L. Martin Co.*, 308 U. S. 62, that the tax was not imposed on the production of the articles; it is not, as in *United States* v. *Cowden Mfg. Co.*, 312 U. S. 34, that the tax was imposed upon one other than the contractor. The reason the court below considers the tax clause inapplicable is simply that its adjustments come into play only if the taxes are "changed by the Congress." We submit that the enjoined processing taxes were "changed by the Congress."

The decisions in *United States* v. *Butler*, 297 U. S. 1, and *Rickert Rice Mills, Inc.* v. *Fontenot*,

297 U. S. 110, established that the processing taxes were unconstitutional because part of a program designed to regulate production, and that the taxpayers were entitled to an injunction against their collection. This "change" in the tax, it is true, occurred immediately upon the decision of this Court. But Congress thereafter both recognized and participated in the elimination of the tax liability.

Title VII of the Revenue Act of 1936, 49 Stat. 1648, contains elaborate provision for the refund of processing taxes collected under the Agricultural Adjustment Act, and is plain congressional recognition that the taxes were invalid.[3] Further evidence of congressional participation in the changed tax liability is found in Titles III and IV of the Revenue Act of 1936. Title III taxes the unjust enrichment which arose as a result of passing on to customers the burden of unpaid taxes.[4] The date of termination of the tax (sections 501 (b) and 501 (i) (2), *infra*) is defined in

[3] Section 902, *infra*, forbids refund of taxes collected under that Act only if the claimant did not bear the burden of the tax, and section 906 (b), *infra*, places on the Commissioner the affirmative duty of making the refunds determined by the Board of Processing Tax Review. Section 907 (c), *infra*, defines "tax period" as terminating on the date of the last actual payment, and is a congressional declaration that no tax was thereafter due or collectible. Section 907 (e) (1), *infra*, speaks in terms of "the termination of the tax."

[4] In defining the income as arising from taxes "imposed on such person but not paid" (sec. 501 (a) (1), *infra*), Congress recognized the abolition of liability for unpaid taxes.

section 501 (j) (2), *infra*, to mean "in the case of a Federal excise tax held invalid by a decision of the Supreme Court, the date of such decision." Title IV contains provisions relating to floor stocks, export and charitable refunds.[5] Section 602 (a), *infra*, offers the floor stocks refund to those who held for sale on January 6, 1936, stocks with respect to which a processing tax was due; the committee reports explain that the provision was designed to remove "certain inequities [which] have resulted from the termination of the processing taxes."[6]

There is no express repeal of the processing taxes imposed under the Agricultural Adjustment Act. But these numerous provisions of the Revenue Act of 1936 show explicit recognition by Congress that the processing tax terminated on January 6, 1936, make provision that a decision of invalidity by this Court should be the equivalent of a repeal by Congress, and establish refund procedures based upon the premise that the processing taxes were ineffective.

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[5] Section 601 (a), *infra*, recognizes the invalidity of the Agricultural Adjustment Act tax machinery by expressly reenacting the refund provisions for the purposes of transactions prior to January 6, 1936, the date of the *Butler* decision. See H. Rpt. No. 2475, pp. 13–14, and S. Rpt. No. 2156, pp. 28–29, 74th Cong., 2d Sess. Similarly, section 602 (c) (1), *infra*, defines a taxable commodity as one on which a processing tax was provided for as of January 5, 1936.

[6] H. Rpt. No. 2475, p. 15; see S. Rpt. No. 2156, p. 29, 74th Cong., 2d Sess.

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These provisions show that a change in the respondent's tax burden has been recognized and confirmed by the Congress. This has two consequences in the interpretation of the tax clause. (a) The respondent's tax liability was unenforceable after the *Butler* decision, in the sense that an injunction could readily be obtained against its collection. But not until the Revenue Act of 1936 was it demonstrable from the statute books alone that there no longer was a liability for the processing taxes, and only by that Act was the statutory liability removed.[7] (b) Even if the *Butler* decision were viewed as removing the statutory as well as the actual liability for processing taxes, the Congress thereafter participated in the change in respondent's tax burden. Its confirmation of the *Butler* decision, whatever its practical effect or cumulative nature, was a change

[7] The distinction between judicial invalidation, making the statute unenforceable, and legislative repeal or recognition of invalidity, may sometimes have significant practical consequences. When the 1935 Term of this Court closed one would have supposed that a flour mill in the State of Washington need pay neither processing taxes to the United States nor minimum wages to its female employees. See *United States* v. *Butler*, *supra*; *Morehead* v. *N. Y. ex rel. Tipaldo*, 298 U. S. 587. Had the Washington legislature moved as promptly as Congress to eliminate the statutory duty, neither statute would exist to trouble the miller. But, because there was no legislative recognition of the invalidity of the minimum wage statute, it soon developed that the statute not only remained in formal existence but was enforceable. See *West Coast Hotel Co.* v. *Parrish*, 300 U. S. 379.

made by Congress in the respondent's tax liability. Under either theory, the tax clause of the contracts requires that the price of the flour be reduced to reflect the "processing tax * * * changed by the Congress."

2. *The Change in Tax Liability Comes Within the Purpose of the Tax Clause.*—Our argument has so far assumed that the issue is to be settled in terms of the bare words of the tax clause, stripped of any meaning beyond that of its precise words. This, of course, is an artificial assumption.

As this Court has long recognized, contracts between the United States and private persons, like all other contracts, are "to be construed with a view to the real intention of the parties." *United States* v. *Gurney,* 4 Cranch 333, 343. See also, *Hollerbach* v. *United States,* 233 U. S. 165. This requires that the Court, in interpreting a clause of the contract, "consider the relations of the parties, their connection with the subject matter of the contract, and the circumstances under which it was signed." *Rock Island Railway* v. *Rio Grande Railroad,* 143 U. S. 596, 609; see, also, *Smith* v. *Bell,* 6 Pet. 68; *United States* v. *Peck,* 102 U. S. 64.

(a) The purpose of the tax clause found in these contracts is apparent. The dual character of the Government's relationship with respondent has already been noted. The fact that the

Government was the tax collector as well as the purchaser of taxable articles made it desirable that so far as possible the effect of the tax on the contract price would be eliminated, since any tax advantage to one of the contracting parties would result in an equivalent disadvantage to the other. The statute, however, provided no basis for exempting the processor from the tax on articles sold to the Government, and Article 9 (b) of Treasury Regulations 81, *infra*, p. 37, expressly held that processing for, or for sale to, the United States was subject to the tax. It was necessary, therefore, to achieve the desired result by a tax clause such as this.

This Court construed a substantially identical clause in *United States* v. *Glenn L. Martin Co.*, 308 U. S. 62. While it held that Social Security taxes were not imposed "on" the articles sold to the United States, it specifically recognized (p. 64) that the clause was intended to stabilize the contractor's margin of profit so far as taxes imposed on the contract articles were concerned. The Comptroller General, proceeding upon the same premise, has ruled in several instances both before and after the execution of the contracts here involved that under the tax clause the contractor was to be reimbursed only for taxes which he was legally obligated to pay and did pay to the United States. 13 Dec. Comp. Gen. 87 (1933); 14 Dec. Comp. Gen. 338 (1934); 15 Dec. Comp. Gen. 674

(1936). In the first of these decisions it was stated (p. 89):

> The conclusion must be reached that unless a contractor has actually paid to the United States the amount of any processing tax in question such contractor may not receive reimbursement of an amount equivalent thereto from the United States. * * *

Finally, in *United States* v. *Cowden Mfg. Co.*, 312 U. S. 34, this Court similarly indicated that the contract provided for reimbursement only of taxes paid by the contractor. Construing a tax clause identical with that involved in the instant case the Court said (pp. 36, 37):

> * * * the fair import of the clause is that the United States must make reimbursement only for such taxes as the contractor has paid pursuant to an obligation imposed upon him by the statute which exacts the tax.
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> * * * * *
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> Moreover, the clause stipulates for reimbursement of taxes "paid by the contractor." It is reasonable to conclude that this phrase also contemplates payment of taxes to the United States in consequence of an obligation imposed by statute upon respondent. * * *

The purpose of the tax clause, then, is clear. The parties were to adjust the contract price to meet tax changes. According as the United States

collected more or less taxes, it was to pay the respondent a greater or smaller purchase price. Thus, the anticipated margin of profit was assured the respondent, whatever the subsequent tax changes; and, whatever those changes, the Government was assured of compensatory price changes to offset tax changes. The evident purpose of the clause and intention of the parties would be frustrated if the clause be construed to exclude a tax change so sweeping as complete invalidity, and elimination of all of the anticipated tax liability.

(b) The tax clause was designed to eliminate the windfall which might otherwise accrue to either the Government or the contractor in consequence of unexpected tax changes. It should be construed so as to preserve the equities of the transaction which the parties sought to insure.

The respondent suggests (Br. in Opp. 19–22) that the unjust enrichment tax imposed by Title III of the Revenue Act of 1936 destroys the equity of the Government's case. But respondent, if it should be required to reduce its sales price by the amount of its unpaid processing taxes, would not be subject to the unjust enrichment tax on these transactions. Section 501 (b) (2), *infra*, excludes the net income from sales with respect to which the taxpayer made a tax adjustment with his vendee, and section 501 (j) (4), *infra*, defines tax adjustment as repayments

"in the bona fide settlement of a written agreement entered into on or before March 3, 1936," a condition which is plainly met in this case. Respondent's complaint makes no claim that it has paid or considers itself liable for the unjust enrichment tax on these transactions.[8] That tax, therefore, does not minimize the inequity of respondent's retention of this windfall.

(c) A number of cases in the lower courts have construed tax clauses in private contracts so as to exclude adjustment of the contract price after the *Butler* decision.[9] Some of these decisions are irrelevant here, because the tax clause contained

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[8] The Comptroller General notified respondent in March 9 and 30 and May 4, 1937, that it was being charged with the amount of these unpaid processing taxes (R. 6–7). Under section 503 of the Revenue Act of 1936, 49 Stat. 1648, respondent's unjust enrichment return would be due (according to the date on which its fiscal year closed) on September 15, 1936, or later. Under section 322 (b) of that Act, respondent could file a claim for refund at least up to July 1939 (within 3 years from date of return, or 2 years from date of payment), which is long after respondent was put on notice that the Comptroller General required a tax adjustment under the contracts in question.

[9] See, also, the decisions denying recovery where the contracts contained no tax clause. *Cohen* v. *Swift & Co.*, 95 F. (2d) 131 (C. C. A. 7), certiorari denied, 304 U. S. 561; *Zinsmaster Baking Co.* v. *Commander Milling Co.*, 200 Minn. 128 (1937) (contract clause not considered at that stage of proceedings); *Thorn* v. *George A. Hormel & Co.*, 206 Minn. 5 (1940); *Mattingly* v. *Smith Milling Co.*, 183 Miss. 500 (1938); *Planters Co.* v. *Brown-Murray Co.*, 128 Pa. Super. Ct. 239 (1937); *Ph. Orth Co.* v. *New Richmond Roller Mills Co.*, 232 Wis. 491 (1939).

no provision for reduction of price [10] or because it was construed as applicable only to the unexecuted portions of the contract and not to past deliveries.[11] But several cases hold that tax clauses contemplating price reductions to offset tax decreases do not warrant recovery after the decision in the *Butler* case.[12] The opinions rely on the absence of an express provision looking to a decision of invalidity by the Supreme Court, and upon the failure of the parties to bill and pay the tax separately from the purchase price of the articles themselves.

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[10] *Continental Baking Co.* v. *Suckow Milling Co.*, 101 F. (2d) 337 (C. C. A. 7).

[11] *Casey Jones, Inc.*, v. *Texas Textile Mills*, 87 F. (2d) 454 (C. C. A. 5); *Golding Bros. Co.* v. *Dumaine*, 93 F. (2d) 162 (C. C. A. 1), certiorari denied, 303 U. S. 660; *O'Connor-Bills, Inc.*, v. *Washburn Crosby Co.*, 20 F. Supp. 460 (W. D. Mo.); *Johnson* v. *Scott County Milling Co.*, 21 F. Supp. 847 (E. D. Mo.); *Carolina Textile Corp.* v. *Eastern Yarn Co.*, 304 Mass. 489 (1939).

[12] *Moundridge Milling Co.* v. *Cream of Wheat Corp.*, 105 F. (2d) 366 (C. C. A. 10); *Consolidated Flour Mills* v. *Ph. Orth Co.*, 114 F. (2d) 898 (C. C. A. 7); *City Baking Co.* v. *Cascade Milling & Elevator Co.*, 24 F. Supp. 950 (D. Mont.); *G. S. Johnson Co.* v. *N. Sauer Milling Co.*, 148 Kan. 861 (1938); *Sparks Milling Co.* v. *Powell*, 283 Ky. 669 (1940); *Crete Mills* v. *Smith Baking Co.*, 136 Neb. 448 (1939); see, also, *United States* v. *American Packing & Provision Co.* (C. C. A. 10), decided Aug. 20, 1941, Prentice-Hall Tax Service, par. 62,898.

In *Johnson* v. *Igleheart Bros.*, 95 F. (2d) 4 (C. C. A. 7), certiorari denied, 304 U. S. 585; *Noll Co.* v. *Sparks Milling Co.*, 304 Ill. App. 624 (1940); and *Southern Biscuit Co.* v. *Lloyd*, 174 Va. 299 (1940), the courts relied equally on the grounds that the contracts did not cover past deliveries and that they did not cover judicial invalidation of the tax.

These decisions do not contradict our position. For the tax clause in private contracts was designed to serve a different purpose than that for which it was used in the Government contracts. The vendees under the former contracts were buying for resale, generally after further processing. The tax burden which they assumed was in turn passed on to their purchasers. The fact that the processor was protected by an injunction against payment of the tax reduced the price to neither his vendee nor to the vendee's customers. Quite naturally, the courts have denied recovery by the vendee of such a windfall, when the tax clauses contemplated a market-wide and simultaneous reduction which would prevent the vendee from recouping the tax burden. They have, accordingly, noted that the buyer would himself be unjustly enriched if he recovered the amount of the tax which had been passed on to his customers.[13]

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[13] Eight of the nine cases (note 12, *supra*) which held that the tax clause in private contracts did not cover invalidation of the tax by this Court have noted this factor. It was an express ground of decision in the *Igleheart* (95 F. (2d) at 9), *Orth* (114 F. (2d) at 903), *City Baking* (24 F. Supp. at 951), *Sauer* (148 Kan. at 869), *Noll* (304 Ill. App. at 629-630), and *Lloyd* (174 Va. at 314) cases. The *Moundridge* case went principally on the ground that the *Sauer* decision was binding (105 F. (2d) at 370). In the *Powell* case, the court assumed (283 Ky. at 671–672) that the seller had paid the tax. The *Crete Mills* case emphasized (136 Neb. at 450, 451) that the seller had paid the unjust enrichment tax under Title III of the Revenue Act of 1936 and that the buyer had refused a rebate based on that portion of the deliveries as to which the

Here, on the other hand, the Government did not buy for resale. Instead, the tax clause was designed to stabilize the transaction so that tax changes, increasing or reducing the revenue of the Government, would be reflected in price changes, increasing or reducing the price paid by the Government, to a precisely compensatory degree. The Government, which could not recoup its tax burden by resale, was thus protected by the tax clause not against a drop in the market price but against a loss in its tax revenues. Thus, the processor's injunctio.. against collection of the tax did not harm his private vendee but did harm the Government. The difference is crucial in the interpretation of the tax clause.

This contrast between the position of the Government and the private vendee, resulting in different purposes to be served by the tax clauses, disposes also of the argument most heavily stressed in denying recovery to the private vendee. That argument is that the amount of the tax is not billed as a separate item but is buried in the total purchase price, and accordingly is not separately recoverable.[14] The tax clause would on first

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seller had paid no processing tax; see, also, *United States* v. *American Packing & Provision Co.* (C. C. A. 10), decided Aug. 20, 1941, Prentice-Hall Tax Service, par. 62,898.

The courts also noted that recovery by the buyer would amount to unjust enrichment because it had in turn passed on the burden of the tax in the *Zinsmaster* (200 Minn. at 133) and *Scott County* (21 F. Supp. at 850) cases.

[14] This ground of decision is mentioned in each of the cases cited above (notes 9 to 12). In *Security Stores* v. *Colorado*

glance be thought a sufficient proof that the parties did in fact view the amount of the tax as a separable item, no matter how the invoices were phrased. But in the case of the private vendee the purpose of the tax clause, to protect him against a market-wide decline in the price of his product, was not fulfilled. Accordingly, it has not been allowed to overcome the inference of the invoices. But where the Government is the vendee, the purpose to be served by the tax clause is fully presented in the noncollection of the taxes. Accordingly, the tax clause remains as an operative guide to the parties' intention and shows that the parties did in truth intend the price to be adjusted according as the taxes were paid or unpaid. The fact that the purchase price did not present the processing tax as a separate item is, therefore, wholly immaterial.

Co., 102 Colo. 471 (1938), the court held a complaint which alleged separate billing of the tax to be good against demurrer. The reasoning reflects the general course of decision in litigation for the recovery by the buyer from the seller of taxes which were reflected in the purchase price but not paid. If the tax was billed separately, a promise to repay the vendee if it is refunded is readily implied. *Wayne County Produce Co.* v. *Duffy-Mott Co.*, 244 N. Y. 351. If buried in the purchase price, the courts see no undertaking to repay the tax any more than any other anticipated but unpaid cost. *Heckman & Co., Inc.*, v. *J. S. Dawes & Son Co.*, 12 F. (2d) 154 (App. D. C.); *Texas Co.* v. *Harold*, 228 Ala. 350 (1933); *Cupples Co., Manufacturers*, v. *Mooney*, 25 S. W. (2d) 125 (Mo. Ct. App., 1930); cf. *Lash's Products* v. *United States*, 278 U. S. 175.

B. WITHOUT REGARD TO THE TAX CLAUSE, THE UNITED STATES CAN RECOVER THE MISTAKEN REIMBURSEMENT FOR UNPAID TAXES

The contracts in question were executed between May 1935 and January 6, 1936 (R. 7). At that time the processing tax collected under the Agricultural Adjustment Act was 30 cents per bushel of wheat, amounting to .704 cents per pound of flour (R. 8). The contract price was 3.23 cents per pound (R. 7). The contracts provided that "Prices set forth herein include any Federal tax heretofore imposed by the Congress which is applicable to the material purchased under this contract" (R. 7).

It is evident that both the United States and the contractor contemplated payment of the processing tax and, as specifically stated in the contract, fixed the price accordingly. It was supposed by both parties to the contract that the respondent was liable for and would pay the processing tax to the United States. Quite obviously, had the parties known that respondent was not liable for and would not pay the tax, the contract price would have been reduced accordingly.

The contract, then, was executed and payment was made at a price which reflected the mutual mistake of the parties. Had the sale been to a private vendee, he probably could not recover because the mistake seems more properly to be considered one of law than of fact.[15] But any such

[15] Even then, the case would not be entirely clear. The general rule is that equity will relieve the parties to a con-

doctrine falls before overriding public policy and does not operate to bar recovery by the United States. Moneys paid out by public officials may be recovered when the payments were based on a mistake of law as well as of fact. *Wisconsin Central R'd.* v. *United States,* 164 U. S. 190, 211–212; *Allen* v. *United States,* 204 U. S. 581; *United States* v. *Wurts,* 303 U. S. 414.[16] The rule applies no less when the mistake is made in the execution or settlement of contracts of the United States. *Steele* v. *United States,* 113 U. S. 128; *United States* v. *Barlow,* 132 U. S. 271, 282; *Grand Trunk Wn. Ry. Co.* v. *United States,* 252 U. S. 112.[17] There is, in short, a "general right of the United States to re-

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tract from a mistake of fact but not of law. *Hunt* v. *Rousmaniere,* 1 Pet. 1, 17. But it is subject to many exceptions, and has been said to be "more honored in the breach than in the observance." *United States* v. *Bentley,* 107 F. (2d) 382, 384 (C. C. A. 2). See, e. g., *Snell* v. *Insurance Co.,* 98 U. S. 85, 90–92; *Philippine Sugar &c. Co.* v. *Phil. Islands,* 247 U. S. 385, 389; *Restatement of Contracts,* American Law Institute, sec. 502, Illus. 4.

[16] See, also, *United States* v. *Saunders,* 79 Fed. 407 (C. C. A. 1); *Leonard* v. *Gage,* 94 F. (2d) 19, 24 (C. C. A. 4); *United States* v. *Bentley,* 107 F. (2d) 382 (C. C. A. 2); *United States* v. *Dempsey,* 104 Fed. 197 (C. C. Mont.); *United States* v. *United States Fidelity & Guaranty Co.,* 151 Fed. 534 (C. C. Md.). The same result was reached, though the question was in form held open, in *McElrath* v. *United States,* 102 U. S. 426, and *United States* v. *Burchard,* 125 U. S. 176.

[17] See, also, *Heidt* v. *United States,* 56 F. (2d) 559 (C. C. A. 5), certiorari denied, 287 U. S. 601; *United States* v. *Sutton Chemical Co.,* 11 F. (2d) 24 (C. C. A. 4); *Cabel* v. *United States,* 113 F. (2d) 998 (C. C. A. 1); *United States* v. *Kerr,* 196 Fed. 503 (C. C. Ore.).

cover moneys paid by the errors of their disbursing officers, as much where the error is one of law as of fact, provided only the moneys belong to the United States *ex aequo et bono.*" *United States* v. *Saunders,* 79 Fed. 407, 408 (C. C. A. 1). The rule reflects the elementary distinction between public and private contracts, for the former are made by "public officers using the funds of the people" and the latter by "individuals dealing with own money where nobody but themselves suffer for their ignorance, carelessness, or indiscretion." *Barnes* v. *District of Columbia,* 22 C. Cls. 366, 394, quoted and approved in *Wisconsin Central R'd.* v. *United States,* 164 U. S. 190, 212.

This distinction makes irrelevant the cases in which the private vendee has been held unable to recover the amount of unpaid taxes which the vendor has included in a composite purchase price.[18] Without a special undertaking to put the seller in funds to meet the tax, represented by a separate billing of the tax, the courts have seen no occasion to relieve the vendee of his failure by contract to specify for return of the part of the purchase price which represents the tax.[19] But where

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[18] The cases are cited in notes 9-12 and 14, *supra.*

[19] Here, in any event, the contract comes within the rule of *Wayne County Produce Co.* v. *Duffy-Mott Co.,* 244 N. Y. 351 (note 14, *supra*). For it specified that the price included existing taxes (R. 7) and the amount of the tax was easily calculable; see *United States* v. *American Packing & Provision Co.* (C. C. A. 10), decided Aug. 20, 1941, Prentice-Hall Tax Service, par. 62,898.

the United States is the buyer, public policy demands that a mistaken expectation that the taxes will be paid be remedied. Otherwise, the seller benefits by a windfall which must be contributed by all the people.[20]

The court in *United States* v. *American Packing & Provision Co.* (C. C. A. 10), decided August 20, 1941, Prentice-Hall Tax Service, par. 62,898, on this ground expressly refused to follow the decisions of the court below and of the Ninth Circuit (*supra*, pp. 10–11). On substantially similar facts it held:

> It is immaterial whether the taxes were paid under mistake of law or fact. * * *
>
> We hold that under the facts here, the Government put the vendor in funds for the payment of a tax, exclusive of the purchase price, calculated by the vendor and which the vendor did not pay, as contemplated by the parties. As a consequence, the vendor received a benefit from the Government, which in justice and good conscience should be returned. The Government having pleaded the same as an equitable setoff, it is entitled to recover against the contract sued upon.

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[20] These considerations are underscored by the contrasting equities between the United States and the private vendee. As we have noted above (pp. 21–22), the latter will ordinarily recoup the tax burden on sale to his customers, while the United States does not resell and at no time is made whole for the loss in tax revenue.

C. THE UNITED STATES IN THE LIGHT OF THE TAX CLAUSE CAN RECOVER THE MISTAKEN REIMBURSEMENT FOR UNPAID TAXES

We have urged that the United States is entitled under the literal terms of the tax clause to recover the amount of the unpaid processing taxes (*supra*, pp. 10–15). Even if the respondent's windfall were not explicitly covered by the tax clause, we have argued that the purpose of that provision yet requires that the amount of the unpaid taxes be deducted from the price (*supra*, pp. 15–23). Finally, without regard to the tax clause, we have relied upon the settled rule that the United States may recover erroneous payments, whether the mistake be one of fact or of law (*supra*, pp. 24–27).

If any one of these positions be sound, the judgment of the Court of Claims must be reversed. But our argument is in truth somewhat broader than the separate parts into which it has been divided. For the judgment of the court below reflects a decision that the doctrine permitting recovery of erroneous payments by the United States is inapplicable, even though the parties by the tax clause plainly intended to stabilize against fluctuating tax burdens both the sellers' margin of profit and the Government's revenues. When these factors are merged, our position becomes even stronger. None of the cases holding that public policy requires recovery by the United States of payments erroneously made by its offi-

cers dealt with a contract through which the parties consciously sought to ensure that result. The result here must accordingly follow *a fortiori*. Conversely, we have urged simply as a matter of contract law and of equity that under the contract the seller should make good through a reduced price the tax revenues lost through the *Butler* decision. If there were doubt as to the force of that argument, it should be dispelled when it is considered that the purchaser was the United States, and that settled public policy dictates recovery of its erroneous payments.

CONCLUSION

It is, therefore, respectfully submitted that the decision of the court below is erroneous and should be reversed.

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SEPTEMBER 1941.

APPENDIX

Budget and Accounting Act, 1921, 42 Stat. 20:

> SEC. 305. Section 236 of the Revised Statutes is amended to read as follows:
>
> "SEC. 236. All claims and demands whatever by the Government of the United States or against it, and all accounts whatever in which the Government of the United States is concerned, either as debtor or creditor, shall be settled and adjusted in the General Accounting Office." [U. S. C., Title 31, Sec. 71.]

Agricultural Adjustment Act, 48 Stat. 31, as amended:

> SEC. 9. (a) To obtain revenue for extraordinary expenses incurred by reason of the national economic emergency, there shall be levied processing taxes as hereinafter provided. When the Secretary of Agriculture determines that any one or more payments authorized to be made under section 8 are to be made with respect to any basic agricultural commodity, he shall proclaim such determination, and a processing tax shall be in effect with respect to such commodity from the beginning of the marketing year therefor next following the date of such proclamation: * * *. The processing tax shall be levied, assessed, and collected upon the first domestic processing of the commodity, whether of domestic production or imported, and shall be paid by the processor. The rate of tax shall conform to the requirements of subsection (b). Such rate

shall be determined by the Secretary of Agriculture as of the date the tax first takes effect, and the rate so determined shall, at such intervals as the Secretary finds necessary to effectuate the declared policy, be adjusted by him to conform to such requirements. The processing tax shall terminate at the end of the marketing year current at the time the Secretary proclaims that all payments authorized under section 8 which are in effect are to be discontinued with respect to such commodity. The marketing year for each commodity shall be ascertained and prescribed by regulations of the Secretary of Agriculture; * * *.

* * * * *

[U. S. C. Supp. V, Title 7, Sec. 609.]

MISCELLANEOUS

SEC. 10. * * *.

* * * * *

(c) The Secretary of Agriculture is authorized, with the approval of the President, to make such regulations with the force and effect of law as may be necessary to carry out the powers vested in him by this title. Any violation of any regulation shall be subject to such penalty, not in excess of $100, as may be provided therein.

* * * * *

[U. S. C. Supp. V, Title 7, Sec. 610.]

COMMODITIES

SEC. 11. As used in this title, the term "basic agricultural commodity" means wheat, rye, flax, barley, cotton, field corn, grain sorghums, hogs, cattle, rice, potatoes,

tobacco, peanuts, sugar beets and sugarcane, and milk and its products, and any regional or market classification, type, or grade thereof; * * *.

[U. S. C. Supp. V, Title 7, Sec. 611.]

Revenue Act of 1936, 49 Stat. 1648:

SEC. 501. TAX ON NET INCOME FROM CERTAIN SOURCES.

(a) The following taxes shall be levied, collected, and paid for each taxable year (in addition to any other tax on net income), upon the net income of every person which arises from the sources specified below:

(1) A tax equal to 80 per centum of that portion of the net income from the sale of articles with respect to which a Federal excise tax was imposed on such person but not paid which is attributable to shifting to others to any extent the burden of such Federal excise tax and which does not exceed such person's net income for the entire taxable year from the sale of articles with respect to which such Federal excise tax was imposed.

(2) A tax equal to 80 per centum of the net income from reimbursement received by such person from his vendors of amounts representing Federal excise-tax burdens included in prices paid by such person to such vendors, to the extent that such net income does not exceed the amount of such Federal excise-tax burden which such person in turn shifted to his vendees.

(3) A tax equal to 80 per centum of the net income from refunds or credits to such person from the United States of Federal excise taxes erroneously or illegally collected with respect to any articles, to the extent that such net income does not exceed

the amount of the burden of such Federal excise taxes with respect to such articles which such person shifted to others.

(b) The net income (specified in subsection (a) (1)) from the sale of articles with respect to which the Federal excise tax was not paid, and the net income specified in subsection (a) (2) or (3), shall not include the net income from the sale of any article, from reimbursement with respect to any article, or from refund or credit of Federal excise tax with respect to any article (1) if such article (or the articles processed therefrom) were not sold by the taxpayer on or before the date of the termination of the Federal excise tax; (2) if the taxpayer made a tax adjustment with respect to such article (or the articles processed therefrom) with his vendee; or (3) if under the terms of any statute the taxpayer would have been entitled to a refund from the United States of the Federal excise tax with respect to the article otherwise than as an erroneous or illegal collection (assuming, in case the tax was not paid, that it had been paid).

* * * * *

(j) As used in this section—

* * * * *

(2) The term "date of the termination of the Federal excise tax" means, in the case of a Federal excise tax held invalid by a decision of the Supreme Court, the date of such decision.

* * * * *

(4) The term "tax adjustment" means a repayment or credit by the taxpayer to his vendee of an amount equal to the Federal excise tax with respect to an article (less reasonable expense to the vendor in con-

nection with the nonpayment or recovery by him of the amount of such tax and in connection with the making of such repayment or credit) if such repayment or credit is made on or before June 1, 1936, or thereafter in the bona fide settlement of a written agreement entered into on or before March 3, 1936.

* * * * *

SEC. 601. REFUNDS UNDER AGRICULTURAL ADJUSTMENT ACT ON EXPORTS, DELIVERIES FOR CHARITABLE DISTRIBUTION OR USE, ETC.

(a) The provisions of sections 10 (d), 15 (a), 15 (c), 16 (e) (1), 16 (e) (3), and 17 (a) of the Agricultural Adjustment Act, as amended, are hereby reenacted but only for the purpose of allowing refunds in accordance therewith in cases where the delivery for charitable distribution or use, or the exportation, or the manufacture of large cotton bags, or the decrease in the rate of the processing tax (or its equivalent under section 16 (e) (3)), took place prior to January 6, 1936.

* * * * *

SEC. 602. FLOOR STOCKS AS OF JANUARY 6, 1936.

(a) There shall be paid to any person who, at the first moment of January 6, 1936, held for sale or other disposition (including manufacturing or further processing) any article processed wholly or in chief value from a commodity subject to processing tax, an amount computed as provided in subsection (b), except that no such payment shall be made to the processor or other person who paid or was liable for the tax with respect to the articles on which the claim is based.

* * * * *

(c) As used in this section—

(1) The term "commodity subject to a processing tax" means a commodity upon the processing of which a tax was provided for under the Agricultural Adjustment Act, as amended, as of January 5, 1936.

* * * * *

SEC. 902. CONDITIONS ON ALLOWANCE OF REFUNDS.

No refund shall be made or allowed, in pursuance of court decisions or otherwise, of any amount paid by or collected from any claimant as tax under the Agricultural Adjustment Act, unless the claimant establishes to the satisfaction of the Commissioner in accordance with regulations prescribed by him, with the approval of the Secretary, or to the satisfaction of the trial court, or the Board of Review in cases provided for under section 906, as the case may be—

(a) That he bore the burden of such amount and has not been relieved thereof nor reimbursed therefor nor shifted such burden, directly or indirectly, * * *.

* * * * *

SEC. 906. PROCEDURE ON CLAIMS FOR REFUNDS OF PROCESSING TAXES.

* * * * *

(b) There is hereby established in the Treasury Department a Board of Review (hereinafter referred to as "the Board"). * * * The Board shall have jurisdiction in proceedings under this section to review the allowance or disallowance of the Commissioner of a claim for refund, and to determine the amount of refund due any claimant with respect to such claim. The Commissioner shall make refund of any

such amount determined by a decision of the Board which has become final. The proceedings of the Board and its divisions shall be conducted in accordance with such rules and regulations as the Board may prescribe, with the approval of the Secretary.

* * * * *

SEC. 907. EVIDENCE AND PRESUMPTIONS.

(a) Where the refund claimed is for an amount paid or collected as processing tax, as defined herein, it shall be prima-facie evidence that the burden of such amount was borne by the claimant to the extent (not to exceed the amount of the tax) that the average margin per unit of the commodity processed was lower during the tax period than the average margin was during the period before and after the tax. If the average margin during the tax period was not lower, it shall be prima-facie evidence that none of the burden of such amount was borne by the claimant but that it was shifted to others.

* * * * *

(c) The "tax period" shall mean the period with respect to which the claimant actually paid the processing tax to a collector of internal revenue and shall end on the date with respect to which the last payment was made. The "period before and after the tax" shall mean the twenty-four months (except that in the case of tobacco it shall be the twelve months) immediately preceding the effective date of the processing tax, and the six months, February to July, 1936, inclusive. * * *

* * * * *

(e) Either the claimant or the Commissioner may rebut the presumption estab-

lished by subsection (a) of this section by proof of the actual extent to which the claimant shifted to others the burden of the processing tax. Such proof may include, but shall not be limited to—

(1) * * * If the claimant asserts that the burden of the tax was borne by him and the burden of any other increased costs was shifted to others, the Commissioner shall determine, from the effective dates of the imposition or termination of the tax and the effective date of other changes in costs as compared with the date of the changes in margin (when margins are computed for weeks, months, or other intervals between July 1, 1931, and August, 1936, in the manner specified in subsection (b)), and from the general experience of the industry, whether the tax or the increase in other costs was shifted to others. * * *

* * * * *

Treasury Regulations 81, promulgated under the Agricultural Adjustment Act:

ART. 9. *Exemptions from processing tax.*—

* * * * *

(b) *Processing by, or for, or for sale to, the United States, a State, or the instrumentality of either.*—Processing for, or for sale to, the United States, a State, a Territory, or a possession, is subject to the tax, whether or not the commodity or the product derived from the commodity is owned by the United States, such State, such Territory, or such possession. Where a State of the United States is engaged in the business of processing, or in processing and the business of selling the articles resulting from such processing, such processing is

subject to tax, and such State is liable, as processor, for the tax. Where a State of the United States is neither engaged in the business of processing, nor engaged in processing and the business of selling articles resulting from the processing, and the processing and disposition of the articles processed are done by the State itself in the exercise of an essential governmental function, such processing is not subject to tax, and such State is not liable for the tax.

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